Several economic and public policy principles should guide the FCC's establishment of network unbundling rules and its application of those rules to particular markets.

22. In its establishment of final network unbundling rules and in its application of those rules to granular evidence about specific local markets, the FCC should adhere to several important economic and public policy principles:

- *Further the goals of the 1996 Act*: Ultimately, the litmus test of whether the final rules are sound is whether they further the goals that Congress set forth in the Act.
- *Issue rules that further congressional goals and the FCC's objectives, as informed by the states:* Because the FCC is now issuing new rules, in those instances where it may disagree with the substantive arguments in the *USTA II* decision (as opposed to the unlawful delegation of authority to states), the FCC can set rules that incorporate the agency's administrative expertise, and that may not conform to the policy issues precisely as the Court frames them.
- *Stability/Minimize consumer disruption*: As the FCC stated in its *NPRM*,[25] it is important to avoid unnecessary instability and consumer disruption. Absent compelling reasons to the contrary, the rules that the FCC adopts in this rulemaking should promote investor confidence in CLECs' operations and consumer confidence in the viability and longevity of competitive choice in the local telecommunications market.

[25] *NPRM*, ¶¶ 1, 10, 20.

- *Consistency with existing law and rules:* The FCC's final rules should be compatible with other telecommunications laws and rules, e.g., Section 271 requirements; state purview over intrastate rates, etc.
- *Consistency with USTA II:* The recommendations, set forth in this Affidavit, are consistent with the directives set forth in *USTA II* and are intended to address the specific failings that the Court identified with the FCC's August 2003 *TRO.*
- *Further the goal of economically efficient local competition:* the FCC should establish UNE rules that encourage the economically efficient deployment of facilities by incumbent and new carriers. Although state or federal regulators should not "pre-select" any particular mode of entry (Congress did not favor any particular mode), assuming, *arguendo,* that the FCC nonetheless chooses to promote facilities-based competition,[26] UNE-P is entirely compatible with such a goal.

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[26] *Id.*, ¶ 2

III. RELEVANT MARKETS

It is essential that the FCC correctly define the relevant markets before it applies its unbundling framework.

23. The FCC seeks comment on "how best to define relevant markets (*e.g.*, product markets, geographic markets, customer classes) to develop rules that account for market variability and to conduct the service-specific inquiries to which *USTA II* refers."[27] The *Triennial Review NPRM*, incorporated by the FCC into the instant *NPRM*, also seeks comment on how best to define markets.[28]

24. In its *NPRM*, the FCC states that the *USTA II* decision requires that it "must account for specific characteristics of the market in which a particular requesting carrier operates" when undertaking its impairment analysis.[29] The D.C. Circuit Court of Appeals found in *USTA II* that "the FCC is obligated to establish unbundling criteria that are at least aimed at tracking relevant market characteristics and capturing significant variation."[30] This follows the Court's objection

[27] *Id.*, ¶ 9.

[28] *Id.*, ¶ 11, footnote 39; *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Notice of Proposed Rulemaking, 16 FCC Rcd 22781 (2001) ("Triennial Review NPRM"*)*, ¶¶ 39, 43, 57-58.

[29] *NPRM*, ¶ 9, footnote 35.

[30] *USTA II*, at 9.

expressed in *USTA I,* to the FCC's issuance of "broad" unbundling rules that apply across all geographic markets and customer classes "without regard to the state of competitive impairment in any particular market."[31]

25. The proper definition of relevant markets is essential for the purpose of assessing whether impairment exists. Relevant markets include product markets (*i.e.*, mass market vs. enterprise market), geographic market (*i.e.*, the physical boundaries), and customer class (*i.e.*, residential vs. business). The FCC cannot undertake an analysis of impairment in the telecommunications market until and unless these markets have been properly defined. If the FCC were to define markets in such a broad manner that a finding of non-impairment was inevitable in most cases, customers would, in fact, *not* have substitutes for ILECs' services in some sub-markets. This would have grave consequences for consumers. If, instead, the FCC properly defined markets, and then identifies markets where impairment does exist, then properly applied unbundling rules will enable nascent competition to take hold.

The delineation between the mass market and the enterprise market should correspond with 24 DSO channels.

26. The FCC addresses the characteristics of the mass market in various portions of the *Triennial Review Order*. Among other things, it states:

> Based on the record before us, it is reasonable to distinguish these three classes of customers - mass market, small and medium enterprise, and large

[31] *Id.*, citing *USTA I*, 290 F.3d, at 422.

enterprise - for several reasons. These classes can differ significantly based on the services purchased, the costs of providing service, and the revenues generated. Because of these differences, for certain network elements the determination whether impairment exists may differ depending upon the customer class a competing carrier seeks to serve.[32]

Mass market customers consist of residential customers and very small business customers. Mass market customers typically purchase ordinary switched voice service (Plain Old Telephone Service or POTS) and a few vertical features. Some customers also purchase additional lines and/or high speed data services. Although the cost of serving each customer is low relative to the other customer classes, the low levels of revenue that customers tend to generate create tight profit margins in serving them. The tight profit margins, and the price sensitivity of these customers, force service providers to keep per customer costs at a minimum. Profits in serving these customers are very sensitive to administrative, marketing, advertising, and customer care costs. These customers usually resist signing term contracts.[33]

Small and medium enterprises are willing to pay higher prices for telecommunications services than the mass market. Indeed, they are often required to do so under business tariffs. Because their ability to do business may depend on their telecommunications networks, they are typically very sensitive to reliability and quality of service issues. These customers buy larger packages of services than do mass market customers, and are willing to sign term contracts. These packages may include POTS, data, call routing, and customized billing, among other services. Although serving these customers is more costly than mass market customers, the facts that enterprise customers generate higher revenues, and are more sensitive to the quality of service, generally allow for higher profit margins. The higher profit margins and greater emphasis on quality of service can provide a greater incentive to competing carriers to provision their own facilities, and

[32] *TRO*, ¶ 124.

[33] *Id.*, ¶ 127, footnote omitted.

> the higher revenues make it easier to cover the fixed costs of installing such facilities.[34]

27. The FCC could differentiate between the mass market and the enterprise market using three possible benchmarks. First, the FCC could rely on the definition that telecommunications carriers use in reporting local competition data to the FCC, which defines mass market as three or fewer lines to a location. Second, the FCC could use a price-based distinction, recognizing that at some "cross over" point, it is less costly for a consumer to order a DS1 line than to order multiple voice grade lines to a particular location. Finally, the FCC could simply determine that lines provisioned at a DS0 level are mass market lines, and lines provisioned at DS1 and above are enterprise market lines.

28. I recommend that for the purpose of differentiating between the mass market and the enterprise market the FCC adopt the last method in its network unbundling rules, *i.e.*, where CLECs are deploying DS0-level lines (whether they are deploying 1 or 23 to a customer), customers are considered to be mass market customers. Customers' choice to purchase DS0 lines rather than DS1 lines reflects information about the price and their assessment of the appropriate cross over between the two products. However, as with mass market customers, I recommend that the FCC in its determination in the instant proceeding assess whether CLECs are serving the entire business market, or only a segment of the market. If, for example, CLECs are only serving

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[34] *Id.*, ¶ 128.

customers with four or more lines, then they should not be considered to constitute direct competition to the ILECs' services.

29. Although reliance on the "economic" cross over point for delineating between the mass and enterprise markets has theoretical appeal, such a determination depends on many variables (*e.g.* DSO and DS1 rates, DS1 multiplexing equipment costs, etc.), which, in turn, are subject to change. The four line carve-out previously set out by the FCC is one example. As the FCC noted in the *Triennial Review Order*, "[a]t some point, customers taking a sufficient number of multiple DS0 loops could be served in a manner similar to that described above for enterprise customers . . . this cross over point may be the point where it makes economic sense for a multi-line customer to be served via a DS1 loop."[35] The FCC opines that the "cross over" point may correspond with the four line carve-out in density zone 1 of the top 50 Metropolitan Statistical Areas ("MSA").[36]

30. As described in Section IV below, Verizon NJ initially proposed that the cross over between mass market and enterprise customers should be determined by whether customers are being served with voice grade DS0 circuits or DS1 loops. However, contrary to Verizon NJ's position in its December 2003 filing with the New Jersey Board, Verizon NJ now seeks to

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[35] *Id.*, ¶ 497.

[36] *Id.*

implement the four line carve out, as described in the *UNE Remand Order*.[37] Verizon NJ notified several CLECs on May 18, 2004, that, effective August 22, 2004, it would no longer provide "unbundled local circuit switching subject to the Four Lines Carve-Out Rule, whether alone or in combination with any other network element" and "unbundled shared transport for use with unbundled local circuit switching subject to the Four Lines Carve-Out Rule."[38] In its attempt to implement the four line carve-out *before* the FCC has ruled on the appropriate distinction between mass market and enterprise customers, Verizon NJ is apparently seeking to obtain at least partial "relief" for a subset of customers within its broader proposed non-impairment markets.

31. Verizon NJ's decision, at this time of regulatory uncertainty, to seek to discontinue access to unbundled local circuit switching under the guise of the four line carve-out is incredible. The FCC extended the four line carve-out in the TRO "on an interim basis" pending regulatory

[37] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, FCC CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696 (1996) ("UNE Remand Order"). *See*, in particular, ¶¶ 276-298. The FCC found that "requesting carriers are not impaired without access to unbundled local circuit switching when they serve customers with four or more lines in density zone 1 in the top 50 [MSAs] . . . where incumbent LECs have provided nondiscriminatory, cost-based access to the enhanced extended link (EEL) throughout density zone 1." *Id.*, at ¶ 278. It appears that the EEL requirement is no longer applicable. See, *TRO*, ¶ 525, footnote 1608.

[38] Letter from Jeffrey A. Masoner, Vice President, Interconnection Services Policy and Planning, Wholesale Marketing (Verizon) to Corey Rinker (Trucom Corporation d/b/a BridgeCom International Inc.), "Notice of Discontinuation of Unbundled Network Elements," May 18, 2004, provided as "Exhibit 1" to letter from Charles C. Hunter, Vice President and General Counsel, BridgeCom International Inc., TruCom Corporation to Kristi Izzo, Secretary, New Jersey Board of Public Utilities, BPU Docket No. TO03090705, dated August 26, 2004.

decisions "to avoid service disruptions that may result from expanding and then possibly reducing the eligibility for local circuit switching in this manner."[39] The FCC's intent was to retain the *status quo*. Instead, Verizon NJ is attempting to force CLECs to migrate their *existing* customers or to pay Verizon NJ a surcharge equal to the resale rate for these lines (in addition to the application of UNE-P rates for the lines).[40]

32. Not surprisingly, the New Jersey Board ordered Verizon NJ to continue providing access to unbundled local circuit switching for a minimum of 90 days from the Court's mandate and reserved the right to "determine whether and how to exercise further review of proposed changes to interconnection agreements in accordance with its Standstill Order and relevant interim FCC rules, said review to include, but not be limited to, establishment of the appropriate demarcation point for the determination of mass-market customers."[41]

33. The Board recognized correctly that the legal landscape pertaining to mass market switching is highly uncertain at this time. The FCC had delegated to the states the responsibility to

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[39] *TRO,* ¶ 525.

[40] Letter from Jeffrey A. Masoner, Vice President, Interconnection Services Policy and Planning, Wholesale Marketing, Verizon, to Corey Rinker, Trucom Corporation d/b/a BridgeCom International Inc., subject: "Notice of Discontinuation of Unbundled Network Elements," May 18, 2004, at 2.

[41] *In the Matter of the Implementation of the Federal Communications Commission's Triennial Review Order*, New Jersey Board of Public Utilities Docket No. TO03090705, Order on Motion for Clarification, August 19, 2004 ("BPU Carve-Out Order"), at 11.

determine whether the four line carve-out had been in effect in their respective states and to determine "the appropriate cut-off for multi-line DS0 customers."[42] *USTA II* vacated the nationwide finding of impairment and the delegation of the analysis of impairment to the states. As such, the Board determined that the four line carve-out was never implemented in New Jersey and that Verizon NJ's use of the carve-out, at this time, "undermines the FCC's rationale underlying" its extension of the four line carve-out on an interim basis.[43]

34. As the Board and the FCC have both acknowledged, the four line carve-out should be re-examined in the context of the entire unbundling framework being contemplated at this time.[44] As such, the FCC still needs to make a market-specific determination with respect to the demarcation point between mass market and enterprise customers. I urge the Commission to refrain from adopting the four line carve-out on a permanent basis.[45] As the FCC recognized in the *TRO*, the four line carve-out has been implemented in just a few areas of the country.[46]

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[42] *TRO*, ¶ 525.

[43] *BPU Carve-Out Order*, at 10.

[44] *Id.*; *TRO*, ¶ 525; The *Triennial Review NPRM* seeks comment on whether a "substantially revised approach [to the four line carve-out] is called for." *Triennial Review NPRM*, ¶ 56.

[45] See *TRO*, ¶ 497, footnote 1546.

[46] *Id.*, footnote 1545.

35. The FCC, in its *Triennial Review NPRM*, expresses some concerns with the four line carve-out. Specifically, while the FCC selected the top fifty MSAs for inclusion because switch deployment appeared to be concentrated in these areas (*i.e.*, at least three switches in most MSAs), the deployment of switches is not a good proxy for evaluating the level of mass market competition, *i.e.*, where customers are actually served throughout a relevant market.[47] In addition, a line-count approach appears to be difficult to implement for specific end-users, who may grow, or expand and contract on a seasonal basis.[48]

36. As Attachment SMB-2 shows, Verizon NJ seeks to implement the "carve-out" in 24 wire centers in New Jersey, 23 of which are within Verizon NJ's proposed non-impairment market. Verizon NJ's position that CLECs are not impaired in these geographic markets, a position which the Ratepayer Advocate and other parties challenged in New Jersey Docket No. TO03090705, does not justify its unilateral attempt to cease providing unbundled switching *before* the FCC has ruled on either (1) the appropriate distinction between mass market and enterprise customers, or (2) whether CLECs are no longer impaired in any particular geographic market. Although Verizon NJ is eager to cut off unbundled switching for these customers because it asserts that CLECs are not impaired in these markets, the granular analysis proves otherwise. *A detailed analysis of New Jersey-specific data indicates that the four line carve-out improperly makes a determination of non-impairment for markets where CLECs are actually still impaired.* I recommend that the FCC

[47]*Triennial Review NPRM*, ¶ 57.

[48]*Id.*, ¶ 59.

recognize mass market customers as those for which CLECs deploy DSO-level lines. The FCC should not maintain the four line carve-out rule, but rather should further define the geographic market for which impairment should be determined as described below.

The unbundling framework should be applied at the wire center level, which is the appropriate geographic market to use in assessing impairment.

37. The *Triennial Review NPRM* seeks comment on how to take geography into account in the FCC's unbundling analysis and what kinds of "geographic delineations would be useful" to such an analysis.[49] The FCC notes that "a service- or location-specific analysis will be administratively more difficult, because it will involve more data and more review" and asks how it should "weigh the benefits of more refined unbundling rules against the administrative burden of conducting the more detailed analysis and applying more complicated rules."[50]

38. In its *Triennial Review Order*, the FCC specifically deferred to states' ability to determine the appropriate level of granularity for assessing whether CLECs would be impaired without access to ILECs' switching elements. The FCC must once again make these determinations, given the Court's decision in *USTA II.* However, the FCC should be guided by the Court's findings in *USTA II*, and, as such, must adopt unbundling rules that take into account varying geographic markets

[49] *Id.*, ¶ 39.

[50] *Id.*, ¶ 40

and customer classes.[51] While it may be tempting to opt for administrative simplicity, the FCC has been barred from adopting broad unbundling rules for the sake of easing administrative burdens. It is imperative that the FCC define the geographic market before it can proceed with its own impairment analysis and application of an unbundling framework.

39. The manner in which the geographic market is defined is critical to the outcome of this proceeding. By way of illustration, were the FCC to define entire states as markets (an option that the FCC prohibited in the *TRO*), and one CLEC were to be self-provisioning in Atlantic City, another CLEC in Newark, and a third in Trenton, one might argue that the FCC-established self-provisioned trigger would be met for all consumers throughout the state. Clearly this approach (which no one is advocating) would be an economically indefensible outcome because consumers in Newark cannot substitute services that a CLEC offers in Trenton. At the other end of the spectrum, if the FCC were to establish a census block group ("CBG") as the relevant market for examination, the presence of a CLEC in one CBG would have no bearing on the FCC's findings in the neighboring CBG, and the analysis would be excessively narrow. Improperly defined geographic markets will mean that CLECs will not be able to serve the mass market using UNE-P, and, therefore, may not be able to serve the mass market at all.

40. The goal in this proceeding should be to designate markets that conform to:

- The actual development of competition;

[51] *USTA II*, at 9.

- The structure of the local market;
- The pricing and regulatory history within the state; and
- Administrative feasibility.

41. While recognizing that the *USTA II* decision found that the FCC's delegation to the states was unlawful, the framework outlined by the FCC in its *TRO* is still applicable to the analysis of impairment now before the FCC. Rule 51.319 states:

> A state commission shall define the markets in which it will evaluate impairment by determining the relevant geographic market to include in each market. In defining markets, a state commission shall take into consideration the locations of mass market customers actually being served (if any) by competitors, the variation in factors affecting competitors' ability to serve each group of customers, and competitors' ability to target and serve specific markets profitably and efficiently using currently available technologies. A state commission shall not define the relevant geographic area as the entire state.[52]

42. In the *TRO*, the FCC states, in pertinent part:

> The triggers and analysis described below must be applied on a granular basis to each identifiable market. State commissions must first define the markets in which they will evaluate impairment by determining the relevant geographic area to include in each market. State commissions have discretion to determine the contours of each market, but they may not define the market as encompassing the entire state. Rather, state commissions must define each market on a granular level, *and in doing so they must take into consideration the locations of customers actually being served (if any) by competitors*, the variation in factors affecting competitors' ability to serve each

[52] §51.319(d)(2)(i).

> group of customers, and competitors' ability to target and serve specific markets economically and efficiently using currently available technologies. While a more granular analysis is generally preferable, states should not define the market so narrowly that a competitor serving that market alone would not be able to take advantage of available scale and scope economies from serving a wider market. State commissions should consider how competitors' ability to use self-provisioned switches or switches provided by a third-party wholesaler to serve various groups of customers varies geographically and should attempt to distinguish among markets where different findings of impairment are likely. The state commission must use the same market definitions for all of its analysis.[53]

The FCC should, in the case before it now, follow similar reasoning.

43. The overriding criterion in determining the geographic market should be whether customers are actually being served.[54] To that end, I recommend that the FCC adopt the wire center. The wire center is logical, corresponds with the economics of the supply and the demand for retail and wholesale services, is administratively feasible, and recognizes disparate customer densities. By contrast, Verizon NJ's proposed geographic market definition in the Commission-mandated state proceeding, and that of other ILECs, is artificial and encompasses wire centers with differing structural attributes.

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[53] *TRO*, ¶ 495, footnotes omitted, emphasis added.

[54] *Id.*, ¶ 495.

44. Much of the germane information about local market structure is based on the ILECs' wire centers. Among the various relevant factors that correspond with wire centers, in the case of the data I analyzed in New Jersey, are the following:

- Verizon NJ's prices charged to the end user (*i.e.*, the retail price against which new entrants must compete, which, in turn, affects their potential revenues).[55]
- Verizon NJ's prices charged to CLECs for UNEs (*i.e.*, the wholesale price new entrants must pay for essential elements, which, in turn, affects their costs).[56]
- The area served by wire centers varies in size and topography, with significantly diverse cost characteristics.[57]
- Availability of collocation space.[58]

45. Although the FCC identifies size as a relevant criterion for determining relevant markets, Verizon NJ not provide information regarding the square mileage of its wire centers (one of the

[55]Verizon NJ charges four different local exchange service rates. The rate for any given wire center depends on its classification among the four exchange groups. Bell Atlantic - New Jersey, Inc., Tariff B.P.U. - N.J. - No. 2, Exchange and Network Services, 8th revised page 30, 7th revised page 31, 6th revised page 32, 7th revised page 33, 8th revised page 34, 7th revised page 35.

[56]Verizon NJ's local UNE loop rates vary among three density zones. Wholesale Loop Costs, *Summary Order of Approval*, New Jersey Board of Public Utilities Docket No. TO00060356, December 17, 2001, Attachment A.

[57]The FCC appropriately identifies the size of the wire center as a potential factor to use in defining geographic markets. *TRO*, ¶ 496.

[58]The FCC specifically identifies "variations in the capabilities of wire centers to provide adequate collocation space" as a relevant factor for defining geographic markets. *Id.*

factors the FCC identifies as a possible criterion for determining geographic markets) stating that "it does not have the requested information."[59] This information would permit an assessment of line density, which, in turn, affects the cost of supplying basic local exchange telecommunications services.

46. Although economic theory relies, in part, on the presence of price discrimination to define markets,[60] in the state filings I examined, the ILECs did not address the fact that their proposed geographic markets encompassed retail and wholesale prices, which vary based upon the wire center. For instance, in the case of Verizon NJ, the range of rates within the Newark and Camden MSAs is further evidence of the excessively broad nature of Verizon NJ's proposed geographic market. Verizon NJ's proposed market includes locations classified in Exchange Group B *(e.g.*, Asbury Park and Fort Dix), Exchange Group C (*e.g.*, Cliffside and Perth Amboy), and Exchange Group D (*e.g.*, Hackensack and Newark).[61] Similarly, wholesale UNE loop rates within Verizon NJ's market areas vary among three density zones. This hodgepodge of wholesale and retail rates (factors which critically affect the profitability of local entry) within the Newark and Camden MSAs demonstrates that Verizon NJ's proposed markets are not based on economic principles.

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[59]Verizon NJ Response to RPA-TRO-93(g).

[60]Horizontal Merger Guidelines, Department of Justice and the Federal Trade Commission, issued April 2, 1992, revised April 7, 1997 ("Horizontal Merger Guidelines"*)*, § 1.12.

[61]Bell Atlantic - New Jersey, Inc. Tariff B.P.U. - No. 2, Exchange and Network Services, 7th revised page 31, original page 32.1, and 8th revised page 34.

47. In their *Horizontal Merger Guidelines*, the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") define a market "as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a 'small but significant and nontransitory' increase in price, assuming the terms of sale of all other products are held constant." The DOJ and FTC explain further that a "relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test."[62]

48. The purpose of this nationwide exercise is to create choice for *customers*, and, therefore, the focus should be on whether customers are *actually* being served. If markets are defined too broadly, they will encompass wire center areas where CLECs may not actually be serving customers in the proposed geographic market. Viewed from the customer's perspective, the fact that a CLEC is serving customers in an adjacent wire center, responding, perhaps in part, to the prevailing (*i.e.*, ILEC) market price, does not translate into competitive choice for the customer in the home exchange, where the CLEC may not have yet raised the capital to install facilities, and/or the prevailing market price is less (thus diminishing revenue opportunities and dampening CLEC interest). If the FCC, contrary to my recommendation, adopts broader markets than the wire center,

[62]*Horizontal Merger Guidelines*, § 1.0.

then the FCC should only consider those CLECs that serve the entire market, not just a portion of the area, as relevant competitors in the mass market.

49. An illustration from New Jersey makes this point. A customer who resides in Bergen County cannot substitute the local service offered by a CLEC in Monmouth County. As I demonstrate in Section IV below, the evidence shows that CLECs compete on a wire center basis, and the mere fact that a CLEC serves a particular wire center does not imply that it serves all 81 zone 1 and zone 2 wire centers in the Newark MSA nor that it serves all fifteen zone 1 and zone 2 wire centers in the Camden MSA. An excessively broad market masks important structural differences within the area.

50. The FCC does caution states in the *TRO* to "not define the market so narrowly that a competitor serving that market alone would not be able to take advantage of available scale and scope economies from serving a wider market."[63] One solution may be to cluster contiguous wire centers that have similar market characteristics. However, although clustering of wire centers has a theoretical appeal, it would not be administratively practical for the FCC, particularly within the limited time frame contemplated for this proceeding, to cluster wire centers accurately.

51. As discussed in Section IV below, Verizon NJ proposed the use of MSAs to define geographic markets for the purpose of the FCC's impairment analysis. Indeed at least three

[63] *TRO*, ¶ 495.

RBOCs (Verizon, SBC and Qwest) all proposed the use of MSAs in their state filings.[64] The proposal to utilize MSAs as the geographic market over which to apply the FCC's unbundling rules has been vague and unsupported by witnesses in the state proceedings. For instance, the New Jersey Ratepayer Advocate propounded several discovery requests seeking the basis on which one of Verizon NJ's witnesses concluded that CLECs will seek to serve customers *throughout* an MSA. The responses indicated that his conclusion was based on general economic theory and that, in fact, CLECs may not seek to serve all portions of the market (*i.e.*, MSA).[65]

52. As discussed in Section IV below, my review of the granular data in New Jersey suggests that there is substantial disparity among wire centers within MSAs in terms of switch deployment and UNE loop activity. Several CLECs may enter one wire center, while choosing not to offer service in another wire center that is within the same MSA. This market behavior would indicate that the CLECs view certain wire centers as being ones that are economic to enter and do make distinctions *on a wire center-basis.* The observed behavior suggests that the ILECs' proposed geographic market boundaries are woefully unsupported and inadequate for the purpose of applying

[64]See, e.g., *In the Matter of Proceeding to Address Actions Necessary to Respond to the Federal Communications Commission Triennial Review Order Released August 21, 2003*, Utah Public Service Commission Docket No. 03-999-04, Direct Testimony of William Fitzsimmons on behalf of Qwest Corporation, January 13, 2004, at iv; *In the Matter of the Implementation of the Impairment Review Mandated by the Federal Communications Commission in its Triennial UNE Review*, Arkansas Public Service Commission Docket No. 03-171-U, Direct Testimony of Jon R. Loehman on behalf of SBC Arkansas Regarding Mass Market Switching, February 10, 2004. Qwest supported the Arkansas PSC's decision to use LATAs, but proposed MSAs as an alternative geographic market. *Id.*, at 26.

[65]Verizon NJ's responses to RPA-TRO-132 through RPA-TRO-137.

the FCC's unbundling analysis. In its *Triennial Review Order*, the FCC addresses such a circumstance, concluding that "if competitors with their own switches are only serving certain geographic areas, the state commission should consider establishing those areas to constitute separate markets."[66]

53. Certainly the ILECs have failed to demonstrate that their proposed "mega-clusters" (*i.e.*, MSAs) correspond with the underlying scale and scope economies that CLECs may have. Where a theoretical concept cannot be supported by a detailed economic assessment, its practical implementation may well harm the development of competition, and therefore consumers. For example, simply because switching equipment *can* serve broad geographic areas, this does not mean the economies of scale and scope justify *actually* serving customers in the broader area. It is critical for the FCC to examine where customers are *actually* being served. CLECs may be able to recover the associated additional collocation and transport costs of serving a large geographic area over only a very small number of customers, thus not justifying the additional expense. The fact that network architecture can support broad deployment is only one relevant factor; more important is whether broadening its market is financially prudent for the CLEC.

54. The market definition that the FCC establishes in this proceeding has long-term implications for local competition in New Jersey and across the nation. It is important to define the market appropriately because the market boundary that the FCC determines in this proceeding will likely

[66] *TRO*, ¶ 496, footnote 1537.

serve as the foundation for future ILEC requests for findings of non-impairment (or similar filings related to network unbundling rules). Therefore, even if, when viewed on an excessively broad area, such as a MSA, the ILECs do not provide evidence of non-impairment at this time, the FCC should not adopt their ill-supported use of the MSA as the relevant geographic market. Separate from the assessment of impairment, the FCC should determine the market boundaries that are best suited for the supply, demand, and consumer features of the local telecommunications mass market.[67] Drawing an excessively broad market presumes an efficiency and intent to serve that may not actually exist.

CLECs are impaired in a given geographic market unless and until CLECs serve residential *and* business customers.

55. CLECs must serve both residential *and* business customers to be considered to be serving the entire mass market. The FCC ordered in the *TRO*, that, "[i]n circumstances where switch providers (or the resellers that rely on them) are identified as currently serving, or capable of serving, only part of the market, the state commission may choose to consider defining that portion of the market as a separate market for purposes of its analysis."[68] There is no evidence that the reasoning behind that guidance is not sound and the FCC should continue to be guided by its analysis in the *TRO* regarding the distinctions in customer class within the mass market. The

[67]Furthermore, in my view, the FCC could more easily *expand* than *contract* the geographic market at a future date, based on more detailed evidence.

[68]*TRO*, footnote 1552. The *TRO Errata* does not change the wording of this footnote, although it does change the sentence to which this footnote refers, i.e., the sixth sentence.

residential and small business markets differ for several reasons, which means that, for the purpose of analysis, the FCC should consider separately whether the relevant sub-markets are actually served by self-provisioning CLECs. It is essential to examine whether mass market customers are being served in both sub-markets, including the residential sub-market and the small business sub-market.

56. The residential market is clearly a distinct customer class within the mass market. ILECs charge different rates for residential and business local exchange service, as the New Jersey data shown in Attachment SMB-3 demonstrate. The ability to price discriminate is evidence of separate markets.

57. The fact that a CLEC has deployed a switch that serves a sub-market, e.g., only small business customers, does not indicate that it will expand its offerings to serve residential customers. The focus should be whether CLECs are *actually* serving customers, not whether they have the potential to do so. It comes down to the observation that if CLECs found it profitable to serve the residential market, they would be doing so. CLECs that are physically able to serve residential customers in a wire centers where they have already deployed a switch have chosen to serve only the business market. There are clearly financial reasons for such a decision.

58. The FCC stated in the *TRO* that "[m]ass market customers are analog voice customers that purchase only a limited number of POTS [plain old telephone service] lines, and can only be

economically served via DS0 loops."[69] CLECs must be serving the entire analog voice mass market. If a CLEC is serving only one class of customers, and not the other, then the CLEC should not count toward the application of the self-provisioning trigger. For this reason, in analyzing the data that CLECs provided in the New Jersey proceeding, I distinguish between instances where CLECs serve residential and business customers to enable the FCC to assess whether CLECs are serving the entire mass market.[70]

[69] *TRO*, ¶ 497.

[70] See Section IV of my Affidavit.

IV. GRANULAR DATA IN NEW JERSEY'S LOCAL MARKETS

Introduction

59. This section of the Affidavit (1) briefly summarizes Verizon NJ's mass market filing; (2) describes the granular data submitted in New Jersey's impairment proceeding; and (3) summarizes the results of my data analysis. Information about New Jersey's local markets is essential to an assessment of whether impairment exists because, as the FCC has stated, "[b]ased on our experience from prior proceedings, we anticipate that we will find evidence of actual marketplace conditions to be more probative than other kinds of evidence, such as cost studies or hypothetical modeling."[71]

Overview of Verizon NJ's mass market impairment filing

Verizon NJ's proposed geographic markets lack empirical justification.

60. Based on data in the Local Exchange Routing Guide ("LERG"),[72] Verizon NJ stated that fourteen CLECs operate 27 local circuit switches located within New Jersey.[73] However, Verizon

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[71] *Triennial Review NPRM*, ¶17.

[72] The LERG is an industry-prepared data base with, among other things, geographic, rating, routing, and numbering data.

[73] Direct Testimony of Harold E. West III and Carlo M. Peduto, II, filed December 3, 2003 ("West/Peduto"), New Jersey BPU Docket No. TO03090705, at 18. On January 16, 2004, Verizon NJ filed supplemental testimony. Supplemental Testimony of Harold E. West III and